RATING REPORT

Aisha Steel Mills Limited

REPORT DATE:
January 15, 2021

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	A-/A-2	A-/A-2
Rating Date	*January 15, 2021*	*October 31, 2019*
Rating Outlook	*Stable*	*Negative*

COMPANY INFORMATION	
Incorporated in 2005	**External auditors:** M/s A. F. Fergusons & Co.
Public Limited Company	**Chairman of the Board:** Mr. Arif Habib
Key Shareholders as on June 30, 2019 (with stake 5% or more):	**Chief Executive Officer:** Dr. Munir Ahmed
Arif Habib Equity (Pvt.) Ltd – 34.18%	
Mr. Arif Habib – 19.61%	
Arif Habib Corporation – 12.00%	
Jubilee Life Insurance Company Limited – 7.99%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (April, 2019) http://www.vis.com.pk/kc-meth.aspx

Aisha Steel Mills Limited (ASL)

OVERVIEW OF THE INSTITUTION

Aisha Steel Mills Limited (ASL) was incorporated in Pakistan on May 30, 2005 as a public limited company. The company was formed to carry out its principal business of manufacturing and selling cold rolled steel in coils and sheets. The company commenced its operations on October 1, 2012 with annual capacity of 220,000 MT. After an expansion, the overall capacity of the company is now at 730,000 MT including CRC and HDGC.

ASML produces Cold Rolled Coils (CRC) and Galvanized Iron (GI) of international quality standards from imported Hot Rolled Coils (HRC). Company's products are used in automotive, industrial, engineering and manufacturing sectors as a premier raw material for further processing into a wide variety of value-added products.

Mr. Arif Habib and his group companies have a cumulative shareholding of 65.79% in ASL as on June 30, 2020.

The board is chaired by Mr. Arif Habib who is an experienced investment professional and has founded the group. Mr. Arif Habib has significant experience in the brokerage sector. The Management team of ASL is spearheaded by Dr. Munir Ahmed who has 24 years of experience in the steel industry. Dr. Munir holds a PHD in Metallurgy and Material Engineering.

RATING RATIONALE

Steel Sector Update

- The outbreak of the novel coronavirus has notably affected several commodity markets, primarily as a result of the demand-weakening effect it has had on a global scale. Consequently, during 5M'CY20, almost all steel producing countries, excluding China, reported a drop in production.

- In International Markets, the prices of HRC remained volatile during the year FY20 fluctuating between USD400 to USD500 per ton. This was due to the prevailing US-China trade war in the first half of FY20 and later because of the pandemic-induced slowdown.

- In Pakistan, the pandemic has further exacerbated the issues of the industry in FY20, which was already undergoing a downswing owing to macroeconomic tightening undertaken by the Government of Pakistan. As a result, the Large-scale Manufacturing (LSM) index dipped by 10.17% in FY20 wherein Iron & Steel products witnessed a drop of 17.36% in FY20 (↓11.21% in FY19), as per the data posted by Pakistan Bureau of Statistics (PBS).

- Nevertheless, as the first lock down ended in Jun'20, LSM grew by 4.81% in Q1'FY21, which is indicative of sharp pick-up in demand in Q1'FY21. Furthermore, given the drop in interest rate and the government entering into its last 2 years, infrastructure spending is expected to pick up, which should drive industry demand going forward.

Rating Rationale

Challenging industry dynamics and high business risk

- Aisha Steel Mills Limited (ASL) and International Steels Limited (ISL) are the only local manufacturers in the flat steel sector with a total installed capacity of 2.0m MT (FY19: 1.7m MT FY18: 1.22m MT). Overall demand of flat steel products contracted by 34% to 0.9m MT during FY20 on the back of weak macroeconomic environment and pandemic-induced slowdown. ASL and ISL cater to the majority of the flat steel demand (62%) while the remaining was met through imports in FY20. ASL imports its major raw material, HRC, mainly from Japan and Taiwan. Despite imposition of Anti-Dumping Duties (ADD) on imports from China and Ukraine, dumping continued due to legal challenges in enforcement of ADD.

Flat Steel Industry	FY19	%	FY20	%
ASL	205,458	17%	258,300	30%
ISL	525,000	43%	275,520	32%
Imports	502,000	41%	327,180	38%
TOTAL	**1,232,458**		**861,000**	

- VIS considers flat steels sector to comprise high business risk given the significant volatility in HRC-CRC margins and threat of dumping.
- Additionally, the steel sector business risk includes significant sensitivity to changes in exchange rate and interest rates, which has been factored into the ratings assigned to industry players.
- As per management of both major flat steel sector players, future off-take will gain impetus from decline in imports due to improvement in implementation of ADD and imposition of preliminary ADD on flat steel imports from Russia. Both players expect volumes to increase due to lower expected imports.
- The shortage of HRC in international market and a timely shipment will remain a near term concern. Synchronization of demand with increased supply and decline in quantum of imports is considered important, going forward.

Operating performance

- The current production capacity of ASL is 700,000 MT; around 450,000 MTS is CRC capacity while around 250,000 MT is HDGC capacity.
- CRC capacity utilization clocked in at 58% in FY20 from 45% in FY19. Production increased to 277,800 in FY20 compared to 202,168 in FY19.
- CRC sales witnessed a decline of 18% to 145,991 (FY19: 178,441) in FY20 owing to a drop in flat steel industry off take amid weakened demand.
- HDGC utilization displayed an increase to 48% (FY19: 13%) with production increasing to 121,137 MTs in FY20 from 33,223 MT in FY19. This was mainly a result of capacity enhancement undertaken by ASL on its HDGC production, which has now increased to 250,000 MTs, from 71,233 previously.
- HDGC off take increased to 112,309 in FY20 from 27,017 last year.
- ASL saw significant success in increasing its market share to 30% in FY20 from 17% the previous year. Note that, in the early half of FY20, ASL plant encountered a fire related incident resulting in loss of 35 days of production.
- In 1QFY21, the sales volume of the company increased to 94,878 MTs (1QFY20: 52,868 MTs) up by 79% YoY.

Profitability witnessed pressure in FY20 due to sizeable finance cost. Going forward, the enhanced topline along with lower financing cost is expected to support profitability.

- The topline of the company grew by notable 47% in FY20 to Rs. 29.7bn from Rs.20.2bn. The growth was contributed by both increase in volumetric sales and prices. In 1QFY21, the sales number displayed a growth of 82% to Rs. 11.2bn (1QFY20: Rs. 6.2bn). Growth was mainly driven by a sharp increase in HDGC off-take.
- The company has sustained its gross at 8% in FY20 relative to last year, albeit lagging historical average of 14% reported between FY16-FY18. The drop in FY19 was mainly caused by rupee devaluation. ASL posted a gross margin of 13% in 1QFY21 (FY20: 9%). Going forward, we anticipate the gross margins to come at 9%-10% levels due to stiff market competition and expected pressure on USD/PKR exchange rate parity.
- The operating margin of ASL remained stable at around 7%. However, the increase in benchmark rates coupled with high quantum of debt resulted in a much higher finance cost. Based on a 2-point average, cost of debt trended up by 488 bpts, while in absolute terms finance cost amounted to Rs. 3.4bn (FY19: Rs. 1.9bn).
- Given the uptick in finance cost, ASL posted a pre-tax loss of Rs. 1.3bn (FY19: Loss of Rs. 412mn).
- The net margin of the company was reported at -2.1% for FY20 (FY19: 1.3%).
- Going forward, ASL's bottom line is expected to derive impetus from the volumetric growth in top line in expected drop in finance cost.
    - Finance cost came in at Rs.1.3bn in FY20 from Rs.0.4bn in FY19 amid increased interest rates environment. In FY21, we expect ASLs profitability to benefit from the reduction in benchmark rates.
    - Assuming sustained gross margins, projected drop in finance cost (assuming 10% YoY growth in total debt), ASL is likely to achieve net margin of ~5% in FY21-22.

Margins Trend (%)	FY17	FY18	FY19	FY20
Gross Margin	14.83%	17.53%	8.30%	7.95%
Operating Margin	13.01%	15.84%	7.18%	6.86%
Effective cost of debt & Lease	12.28%	10.34%	8.54%	17.49%

Cash flow coverage indicators are expected to improve

- The company operates with an operating of ~100 days as historically observed. In FY20, the company's operating cycle decreased from 117 days to 103 days, mainly being contributed by the drop in inventory days (higher off-take) and increase in creditor days.
- During FY20, given the pressure on profitability, the company's FFO dropped from Rs. 708m to negative Rs. 850m. As a result, the company's DSCR was impacted, falling to 0.6x. Going forward, on the back of improved bottom line forecast, the DSCR is projected to rise above 1.25x during the rating horizon.
- Furthermore, FFO-LT Debt is expected to rise above 0.2x.
- The short-term borrowings are sizable, albeit they have dropped in Q1'FY21 from Rs. 9.9b to

Rs. 5.2b. This was mainly on account of a drop in inventory days. Nevertheless, as of Sep'20, the ratio of inventory & trade debts to short term debt stood at 0.6x, indicating that short term debt remains on the higher side.

Leverage indicators are expected to continue to remain elevated over the rating horizon

- Equity base of the company declined to Rs. 6.7bn (FY19: Rs. 7.2bn) due to loss in FY20. However, profits in 1Q'FY21 translated in some improved in equity base to Rs. 6.9b.
- Leverage climbed up to 3.97x in FY20 from 3.31x in FY19 as long term debt increased to Rs.9.35bn as at end-FY20 (FY19: Rs. 7.68bn).
- ASL's capital structure has depicted improvement in Q1'FY21, given positive net margin and full profit retention.
- Both gearing and leverage have moved down, albeit are still considered to be on the higher side vis-à-vis the rating threshold. However, given our profitability projections, gearing is expected to further trend down during the course of the rating horizon.

	Jun'19	Jun'20	Sep'20
Gearing	3.02	2.91	2.16
Leverage	3.31	3.97	2.88

Aisha Steel Mills Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**Jun'16**	**Jun '17**	**Jun'18**	**Jun'19**	**Jun'20**
Fixed Assets	9,689	10,543	13,374	20,133	19,007
Deferred Tax Asset	1,134	1,358	933	1,344	2,159
Stock-in-Trade	2,814	3,716	4,312	6,920	7,916
Trade Debts	77	152	105	599	163
Cash & Bank Balances	45	861	46	209	183
Total Assets	15,353	18,184	20,426	32,731	34,509
Trade and Other Payables	2,773	3,561	1,210	1,234	6,293
Long Term Debt	5,827	5,289	5,390	7,720	9,410
Short Term Debt	3,870	2,435	5,045	14,112	9,946
Total Debt	9,697	7,724	10,435	21,832	19,357
Paid Up Capital (Ordinary Shares)	2,717	6,856	8,323	7,655	7,655
Total Equity	2,273	5,476	6,933	7,235	6,652
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Net Sales	9,634	14,076	18,904	20,231	29,777
Gross Profit	980	2,087	3,314	1,678	2,366
Operating Profit	829	1,831	2,995	1,453	2,043
Profit / (Loss) Before Tax	(192(	882	1,916	(412)	(1,343)
Profit After Tax	(155)	1,020	1,284	254	(616)
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Gross Margin (%)	10.2%	14.8%	17.5%	8.3%	7.9%
Net Margin	-1.6%	7.2%	6.8%	1.3%	-2.1%
Net Working Capital	(2,872)	(181)	(942)	(5,547)	(3,661)
Trade debts/Sales	1%	1%	1%	3%	1%
FFO	204	1,426	2,028	708	(850)
FFO to Total Debt (%)	2%	18%	19%	3%	-4%
FFO to Long Term Debt (%)	4%	27%	38%	9%	-9%
Current Ratio (x)	0.61	0.97	0.87	0.67	0.78
Debt Servicing Coverage Ratio (x)	1.25	1.76	3.13	1.16	0.62
Gearing (x)	4.27	1.41	1.51	3.02	2.91
Leverage (x)	5.59	2.10	1.72	3.31	3.97
Stock+Trade Debts/STB	75%	159%	88%	53%	81%
ROAA (%)	-1%	6%	7%	1%	-2%
ROAE (%)	-7%	26%	21%	4%	-9%

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Aisha Steel Mills Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
January 15, 2021	A-	A-2	Stable	Maintained
October 31, 2019	A-	A-2	Negative	Maintained
October 2, 2018	A-	A-2	Stable	Reaffirmed
October 5, 2017	A-	A-2	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meeting Conducted	

Name	Designation	Date
Dr. Munir Ahmed	CEO	November 25, 2020